

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF CALIFORNIA

SECURITIES AND EXCHANGE
COMMISSION,

Plaintiff,

v.

SASAN SABRDARAN, et al.,

Defendants.

Case No. [14-cv-04825-JSC](#)

**ORDER GRANTING IN PART MOTION
TO DISMISS AND DENYING MOTION
TO STRIKE**

Re: Dkt. Nos. 21, 22

Plaintiff Securities and Exchange Commission (“SEC”) alleges that Defendants Sasan Sabrdaran (“Sabrdaran”) and Farhang Afsarpour (“Afsarpour”) violated the antifraud provisions of the Securities Exchange Act of 1934 (“Exchange Act”). (*See* Dkt. No. 1.) The gravamen of the complaint is that Defendants engaged in insider trading; specifically, that Sabrdaran, an employee of pharmaceutical company InterMune, Inc. (“InterMune”), tipped Afsarpour to material non-public information about the progress through the European regulatory approval process of Esbriet, one of InterMune’s products, and that Afsarpour acted on that tip by engaging in transactions in connection with InterMune securities. (*See id.* ¶ 1.) Now pending before the Court are Sabrdaran’s Motion to Dismiss the complaint and Motion to Strike portions of the complaint. (Dkt. Nos. 21, 22.) Having considered the parties’ submissions, and having had the benefit of oral argument, the Court GRANTS IN PART Sabrdaran’s motion to dismiss and DENIES the motion to strike.

BACKGROUND

A. Complaint Allegations

This case arises out of allegations of insider trading involving transactions in the securities of InterMune, a then-publicly traded pharmaceutical company incorporated under the laws of

Delaware and headquartered in Northern California. (Dkt. No. 1 ¶ 1, 5.) At all relevant times, InterMune’s common stock was registered with the SEC under Exchange Act Section 12(b); InterMune stock traded on the NASDAQ stock market, and InterMune options also traded on various exchanges. (*Id.*) InterMune also filed periodic reports with the Commission as the Exchange Act requires. (*Id.*) Sabrdaran, a trained physician and resident of San Francisco, worked as the director of Drug Safety Risk Management at InterMune from April 2006 until his termination in March 2012. (*Id.* ¶ 7.) Afsarpour is a British citizen who resides in England. (*Id.* ¶ 8.) Sabrdaran and Afsarpour had been close friends for years, speaking on the phone often, visiting each other regularly, and caring for each other’s ailing parents. (*Id.* ¶ 25.)

This case involves tipping of material, non-public information pertaining to the regulatory approval process to market an InterMune pharmaceutical product for use in the European Union (“EU”), which Sabrdaran was intimately involved in. Before turning to the allegations specific to the approval process for the product at issue here, background on the EU marketing authorization approval process in general is helpful.

Marketing Authorization Approval Process Before the European Medicines Agency

The European Medicines Agency is responsible for approving pharmaceutical drugs for marketing in the EU. The Committee for Medicinal Products for Human Use (“CMPH”), a scientific advisory committee, prepares the European Medicines Agency’s opinions on medicines. (*Id.* ¶ 13.) Upon receipt of a marketing approval application (“MAA”), the CMPH appoints two members, designated the Rapporteur and co-Rapporteur, to assess the drug. (*Id.*) The Rapporteurs issue formal questions and comments to the applicant in prescribed formats at established intervals: the first communication is issued 80 days after receipt of the MAA, then 120 days, 150 days, 180 days, and 210 days—all excluding the time the applicant takes to respond to each inquiry. (*Id.*) Informal communication may also occur between the CMPH and the applicant throughout this process, which culminates in the Rapporteur’s presentation of findings and recommendation to the CMPH for a vote on the opinion. (*Id.*)

Thus, the usual time frame for presenting a recommendation to the CMPH is 210 days after the receipt of an MAA, excluding the applicant’s response time. (*Id.* ¶ 14.) Rarely the

1 CMPH may be able to issue an opinion within 180 days. (*Id.*) In any event, the CMPH then
 2 forwards its opinion to the European Medicines Agency for ratification. (*Id.*) Once the European
 3 Medicines Agency ratifies the CMPH's decision, the particular medicine at issue is marketable
 4 throughout the EU. (*Id.*)

5 *InterMune's Marketing Authorization Application for Esbriet*

6 InterMune manufactures Esbriet to treat idiopathic pulmonary fibrosis, a fatal lung disease.
 7 (*Id.* ¶ 12.) In March 2010, InterMune submitted to the European Medicines Agency an application
 8 for approval to market its Esbriet in the EU. (*Id.* ¶¶ 1, 12.) A small team of employees at
 9 InterMune was responsible for shepherding Esbriet through the European Medicines Agency's
 10 regulatory process. (*Id.* ¶ 15.) Sabrdaran was one member of this group, referred to throughout
 11 the complaint as the "Esbriet Team." (*Id.*)

12 After submitting its MAA in March of 2010, InterMune made public statements that it
 13 anticipated a CMPH and European Medicines Agency decision in the first half of 2011. (*Id.*) On
 14 a telephone call on October 28, 2010, InterMune's Chief Executive Officer stated that this
 15 anticipated timing was based on the "typical timeline" for the CMPH rendering a decision 210
 16 days after submission "if everything goes perfectly." (*Id.*) Later in 2010—specifically, on June
 17 15, July 23, and September 15—the Esbriet Team received communications that the review was
 18 going even better than anticipated. (*Id.* ¶ 16.) During this time period, Sabrdaran learned of
 19 positive developments set forth in the Day 80 report and Day 120 list of questions. (*Id.* ¶ 26.)

20 On November 15, 2010, a European Medicines Agency liaison emailed a consultant for
 21 InterMune indicating that "most probably Esbriet will go for a positive Opinion" at the CMPH's
 22 vote during its December 2010 meeting, which was scheduled for December 13 through 16, 2010.
 23 (*Id.* ¶ 17.) On November 16 and 17, another European Medicines Agency employee confirmed as
 24 much, stating that the "trend is positive" and there were "no major issues" with InterMune's
 25 application. (*Id.*) On November 29, 2010, the Rapporteurs issued the formal Day 150 report,
 26 which stated that Esbriet "could be approvable" provided that InterMune satisfactorily responded
 27 to some outstanding issues. (*Id.*)

28 On December 2, 2010, InterMune's consultant emailed InterMune personnel, including

1 Sabrdaran, and wrote that he “had [] feedback from the Rapporteurs and they think that
2 [InterMune] can reach a positive opinion in December, as long as all the issues are resolved and []
3 no other concerns are raised between now and the end of the [CMPH review].” (*Id.* ¶ 18.) An
4 InterMune employee responded to this email by emailing the Esbriet Team, including Sabrdaran,
5 on December 2, 2010, writing, “This is great news!” (*Id.*)

6 The CMPH’s reply to InterMune’s Day 150 responses stated, for the first time, that Esbriet
7 “is approvable” provided that InterMune committed to perform certain post-approval follow-up
8 measures. (*Id.* ¶ 19.) The week of December 6, 2010, the EMA liaison confirmed that Esbriet
9 would be put up for a positive opinion during the CMPH’s meeting on December 13 through 16,
10 2010. (*Id.*)

11 All of the foregoing communications were private and confidential, and subject to
12 InterMune’s policy to share the communications only on a need-to-know basis, even internally.
13 (*Id.* ¶ 20.) InterMune’s policy until its December 17, 2010 announcement—*i.e.*, until *after* the
14 CMPH voted to issue a positive opinion—was to refrain from any public comment “on the content
15 or tone of any dialogue with the [European Medicines Agency], including the [CMPH],
16 concerning its application to market Esbriet in the EU.” (*Id.*)

17 On December 17, 2010, InterMune publicly announced that the CMPH had issued a
18 positive opinion. (*Id.* ¶ 21.) InterMune’s stock and options prices increased significantly: as of
19 December 20, 2010, its stock price more than doubled, and its call options showed an even bigger
20 spread. (*Id.* (call option with April 2011 expiration increased nearly 5-fold, while call option with
21 a December 2010 expiration increased a multiplier of more than 200).)

22 *Sabrdaran’s Knowledge of Material Non-Public Information*

23 Because Sabrdaran was on the Esbriet Team, he was contemporaneously aware of the
24 communications between the European Medicines Agency and InterMune and the fact that Esbriet
25 was on calendar for a positive opinion vote at CMPH’s December 2010 meeting. (*Id.* ¶ 22.)
26 Sabrdaran was also privy to a number of the communications listed above; he saw the Day 80
27 report and Day 120 list of questions, the Day 150 Report; the December 2, 2010 email from
28 InterMune’s consultant and the internal response; as well as the CMPH’s reply to InterMune’s

Day 150 response, which unequivocally stated that Esbriet was approvable. (*Id.* ¶¶ 22, 26.)

Sabrdaran also received other communications regarding Esbriet’s status in the regulatory process and its likely approval. One such communication was a December 8, 2010 email from the InterMune’s Chief Regulatory and Drug Safety Officer titled “EU Update—HIGHLY CONFIDENTIAL” that the CMPH had moved its consideration of Esbriet to the afternoon of December 14, 2010. (*Id.*) The following day, the same InterMune executive sent the Esbriet Team, including Sabrdaran, an email indicating that “over the past 2 weeks we have succeeded in converting our applications classification from [‘]could be approvable[’] to [‘]is approvable.[’]” (*Id.*)

Sabrdaran also was privy to a slew of documents that emphasized his duty of confidentiality with regard to InterMune information generally, and information about Esbriet’s application process in particular. (*See id.* ¶¶ 23-24.) Generally, Sabrdaran’s employment letter of February 2006 stated that he had a duty of confidentiality, and he signed a document acknowledging this duty in April of that year. (*Id.* ¶ 23.) Similarly, Sabrdaran’s written performance review for 2010 specified that Sabrdaran had a duty to protect InterMune’s confidential and proprietary information and was subject to the company’s policy against insider trading and tipping. (*Id.*)

With respect to information about Esbriet in particular, on November 18, 2010 Sabrdaran received an email indicating that the company could not “stress enough how critically **confidential** the Day 150 [List of Issues] will be. Please do not discuss with anyone prior to our meeting[.]” (*Id.* ¶ 24 (emphasis in original).) On November 29, 2010, Sabrdaran received an email from the InterMune executive leading the Esbriet approval process reminding the Esbriet team to “please maintain 100% confidentiality.” (*Id.*) On December 2, 2010, InterMune imposed a trading blackout period on Sabrdaran and other employees who knew about the progress of InterMune’s regulatory approval. (*Id.*) Sabrdaran also warned others about the importance of confidentiality: the same day, he emailed InterMune’s consultant asking him not to “share the possibility of early/Dec opinion with anybody else at InterMune.” (*Id.*)

Sabrdaran's Tipping

Telephone and text message records from June through December 2010 indicate that Sabrdaran communicated regularly with Afsarpour during this time, and some of these communications preceded Afsarpour “taking actions consistent with Sabrdaran apprising him of developments relating to” the confidential information about the CMPH’s processing InterMune’s MAA for Esbriet. (*Id.* ¶ 26.) For example, on October 10, 2010, Sabrdaran—who at the time had learned of the CMPH’s positive news from the Day 80 and Day 120 reports—spoke with Afsarpour on the phone for 40 minutes. (*Id.*) The following day, Afsarpour opened a spread betting account with IG Index, a London financial company.¹ (*Id.*) Afsarpour placed spread bets on InterMune common stock in November 2010—*i.e.*, bets that banked on the increase in price of the underlying security—which were the first spread bets he had ever placed on equities. (*Id.* ¶¶ 27-28.)

Likewise, on November 29, 2010, Sabrdaran, who was in London for Esbriet Team meetings with the CMPH, had seen the Day 150 report just one day earlier, which disclosed the CMPH’s statement that Esbriet would likely be approved at the December meeting. (*Id.* ¶ 29.) The following day, Sabrdaran and Afsapour spoke on the telephone for 39 minutes. (*Id.*)

Similarly, on December 10, 2010, Afsarpour left Sabrdaran a voicemail in Farsi saying, “I thought you might have some new news for me[.]” (*Id.* ¶ 30.) Later that day the two men spoke for 22 minutes. (*Id.*) Within the three days leading up to this conversation, Sabrdaran had learned of the CMPH’s reply to the Day 150 responses, which characterized Esbriet as “is approvable” for the first time. (*Id.*) Sabrdaran had also seen the internal InterMune emails celebrating that characterization. (*Id.*)

Afsarpour's Stock Purchases and Spread Bets

At a poker night in Afsarpour’s home on December 12, 2010, he urged approximately six friends to purchase InterMune securities. (*Id.* ¶ 31.) Afsarpour told the friends that they would need to move quickly before a favorable decision on InterMune’s application to market Esbriet

¹ “A spread bet is an agreement in which the purchaser purchases from a counterparty the opportunity to profit from changes in the price of an underlying asset[.]” (Dkt. No. 1 ¶ 27.)

1 was approved, and if they did not have their own accounts, they could give Afsarpour money to
2 purchase securities for them through his own account. (*Id.*)

3 On December 13, 2010, Afsarpour sent a Facebook message to a friend in Farsi noting that
4 he tried to contact the friend by phone because Afsarpour had “good news” to share and it was
5 “not too late if you have money.” (*Id.* ¶ 32.) In the Facebook messages that followed, Afsarpour
6 agreed to buy InterMune shares on the friend’s behalf in exchange for the friend buying \$17,940
7 in gold for Afsarpour. (*Id.*) Likewise, on December 17, 2010, prior to the public announcement
8 that the CMPH had approved Esbriet, Afsarpour confirmed to another friend via e-mail that he
9 received over £20,000 from the friend, who responded, “thank God that it got there in time. I hope
10 that we become rich people.” (*Id.* at ¶ 33.)

11 Afsarpour also made several purchases for himself. On December 16, 2010, the day before
12 the public announcement, Afsarpour purchased 75 shares of InterMune common stock through his
13 account at National Securities Corp. in New York. (*Id.* ¶ 34.) Between December 9 and 16,
14 Afsarpour deposited £134,500 into his IG Index spread betting account, including £87,000 that he
15 obtained from friends. (*Id.* ¶ 35.) Part of this deposit was £20,000 in cash advances from
16 Afsarpour’s credit card. (*Id.*) This was the first time that Afsarpour had ever used his credit card
17 to obtain a cash advance for spread betting. (*Id.*)

18 Afsarpour’s spread bets after December 10, 2010 were different from the ones he placed
19 before inasmuch as they (a) included not only daily bets but quarterly bets; (b) were based not
20 only on the price of InterMune common stock but InterMune call options; (c) were significantly
21 larger bets; and (d) were not subject to stop loss instructions.² (*Id.* ¶ 36.) The disclosure
22 documents that Afsarpour received from IG Index when he opened his spread bet account
23 indicated that the company may hedge its liability by opening analogous positions on the
24 market—*i.e.*, purchasing the securities underlying the spread bet—and stated that Afsarpour “will
25 not place . . . a Bet that contravenes any primary or secondary legislation or other law against
26

27 ² A stop loss instruction or stop loss order tells a broker to either buy or sell shares of the stock if a
28 specified price is reached. It is designed to prevent excessive losses on a stock trade. *What is a
Stop-Loss Order to Sell?*, Finance.Zacks.Com, <http://finance.zacks.com/stoploss-order-sell-9808.html> (last visited Feb. 26, 2015).

insider dealing[,]” *i.e.*, insider trading. (*Id.* ¶ 37.) IG Index did in fact hedge Afsarpour’s spread bets by purchasing substantial amounts of InterMune call options traded on a U.S. exchange. (*Id.* ¶ 38.) IG Index would only post the spread bet to Afsarpour’s account after hedging by purchasing the options. (*Id.*) IG Index purchased its options through Barclays Capital, a broker dealer registered in New York. (*Id.*)

In sum, Afsarpour’s trading—in terms of both the 75 shares of common stock he purchased and the spread bets he made—yielded \$877,369 in profits. (*Id.* ¶¶ 34, 39.)

Afsarpour’s Tipping

Afsarpour also tipped two friends, referred to in the complaint as Pharmacist No. 1—a resident of England—and Hairdresser No. 1—a California resident formerly related by marriage to Afsarpour. (*Id.* ¶¶ 10-11, 40.) Afsarpour and the pharmacist spoke on the phone on December 10, 11, and 13, 2010 in calls ranging from 2 to 16 minutes. (*Id.* ¶ 41.) They spoke again on December 17, 2010 for 8 minutes after InterMune announced that the CMPH had issued a positive opinion approving Esbriet. (*Id.*) The next day, December 18, following the public announcement, they spoke for 25 minutes. (*Id.*) On December 14, 2010, the pharmacist placed a spread bet on InterMune common stock; this first bet was unsuccessful and he deleted it. (*Id.* ¶ 42.) On December 16, 2010, the pharmacist placed an even higher spread bet; by December 20, his bets yielded \$107,900 in profit. (*Id.* ¶ 43.)

The hairdresser spoke with Afsarpour about InterMune the week of December 12. (*Id.* ¶ 44.) She opened a brokerage account on December 13, 2010; deposited \$60,000 in the account via wire transfer on December 15, then purchased 4,250 shares of InterMune on December 16, 2010. (*Id.*) By December 20, the hairdresser’s investment in InterMune stock yielded \$91,800 in profit.

If the pharmacist and hairdresser’s profits are imputed to Sabrdaran and Afsarpour, Defendants’ profits from the insider trading total \$1,077,069. (*Id.* ¶ 46.)

Defendants’ Conduct After the SEC’s Investigation Began

When the SEC first contacted Afsarpour to discuss his InterMune trading activity, Afsarpour informed the SEC that he “happened across” InterMune’s stock when he mistakenly

1 typed the wrong ticker symbol into a search engine. (*Id.* ¶ 48.) He stated that he intended to type
 2 symbol “ITNMD” for International monetary Systems LTD, but instead typed the symbol
 3 “ITMN” for InterMune. (*Id.* ¶¶ 9, 48.) Afsarpour did not mention to the SEC that he knew
 4 Sabrdaran. (*Id.* ¶ 48.) However, Afsarpour later told one of the attendees of the December 2010
 5 poker game at his house that he had been tracking InterMune’s stock performance since 2009,
 6 when he learned that Sabrdaran worked there. (*Id.*)

7 In March of 2011, Afsarpour paid \$26,000 to Sabrdaran. (*Id.* ¶ 49.) Two months later,
 8 when the SEC faxed Sabrdaran’s attorney a document request, which included a request to search
 9 Sabrdaran’s computers, Sabrdaran used file cleaning software on his work laptop to delete files.
 10 (*Id.* ¶ 50.)

11 **B. Procedural History**

12 The SEC initiated this action on October 30, 2014. The one-count complaint alleges that
 13 Defendants, in connection with the purchase or sale of a security, by use of means or
 14 instrumentalities of interstate commerce, mails, or a national securities exchange, have employed
 15 devices, schemes, or artifices to defraud; made untrue statements of material fact or omitted to
 16 state material facts necessary in order to make the statement not misleading; or engaged in acts,
 17 practices or courses of business which have operated or would have operated as a fraud or deceit
 18 upon persons in violation of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. (Dkt.
 19 No. 1 ¶ 54.)

20 The SEC contends that Sabrdaran tipped Afsarpour either deliberately or recklessly to
 21 material, non-public information regarding InterMune’s progress in the regulatory approval
 22 process for Esbriet’s market approval in the EU. (*Id.* ¶ 52.) The complaint alleges that Sabrdaran
 23 knew the information was material and non-public, and that in sharing the information with
 24 Afsarpour he breached his fiduciary duty of confidentiality to InterMune shareholders for an
 25 improper purpose. (*Id.*) The complaint further alleges that Sabrdaran received a personal benefit
 26 in tipping Afsarpour. (*Id.*) The SEC likewise contends that Afsarpour knew the information was
 27 material and non-public and that Sabrdaran had breached his duty by disclosing the information to
 28 him. (*Id.* ¶ 53.) Afsarpour nonetheless used this information to trade stock and place spread bets

for himself and others, and also tipped others—Pharmacist No. 1 and Hairdresser No. 1, who themselves purchased InterMune stock and placed spread bets based on this information. (*Id.*)

By way of relief for the alleged violations, the SEC seeks judgment: (1) enjoining Defendants from further violating Section 10(b) and Rule 10b-5; (2) ordering Defendants to disgorge, with pre-judgment interest, any ill-gotten gains as a result of their conduct; (3) ordering Defendants to pay civil penalties pursuant to Section 21A of the Exchange Act; (4) barring Sabrdaran from servicing as an officer and director pursuant to Section 21(d)(2) of the Exchange Act; and (5) any other relief as the Court may deem just and appropriate. (Dkt. No. 1 at 15.)

After the complaint was filed, Plaintiff and Sabrdaran each filed a consent to proceed before a magistrate judge, and shortly thereafter Sabrdaran filed the instant motions. (*See* Dkt. Nos. 11, 12, 21, 22.) Sabrdaran has filed a motion to dismiss the complaint in its entirety pursuant to Rule 12(b)(6) (Dkt. No. 21), as well as a motion to strike portions of the complaint (Dkt. No. 22). Afsarpour has since waived formal service of process and likewise consented to magistrate jurisdiction. (Dkt. Nos. 27-28.) Afsarpour has not yet answered the complaint or formally joined the instant motions, though his counsel appeared in court at the February 26, 2015 hearing on Sabrdaran’s motions.³ Given all parties’ consent, the instant motions are properly before the Court. *See* 28 U.S.C. § 636(c).

LEGAL STANDARD

A. Motion to Dismiss

A Rule 12(b)(6) motion challenges the sufficiency of a complaint as failing to allege “enough facts to state a claim to relief that is plausible on its face.” *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 570 (2007). A facial plausibility standard is not a “probability requirement” but mandates “more than a sheer possibility that a defendant has acted unlawfully.” *Ashcroft v. Iqbal*,

³ Counsel for Afsarpour appeared at the February 26, 2015 hearing on Sabrdaran’s motion, and the SEC suggested deferring resolution of the instant motion until Afsarpour filed his own. Counsel for Afsarpour indicated that Afsarpour likely would not file a Rule 12(b)(6) motion to dismiss in the event the Court denies the motions currently before the Court, and therefore suggested that the Court resolve the instant motions even though Afsarpour had not yet formally joined them. The Court will treat the motions as if Afsarpour joined in them so that his objections are preserved for the record.

556 U.S. 662, 678 (2009) (internal quotations and citations omitted). For purposes of ruling on a Rule 12(b)(6) motion, the court “accept[s] factual allegations in the complaint as true and construe[s] the pleadings in the light most favorable to the non-moving party.” *Manzarek v. St. Paul Fire & Mar. Ins. Co.*, 519 F.3d 1025, 1031 (9th Cir. 2008). “[D]ismissal may be based on either a lack of a cognizable legal theory or the absence of sufficient facts alleged under a cognizable legal theory.” *Johnson v. Riverside Healthcare Sys.*, 534 F.3d 1116, 1121 (9th Cir. 2008) (internal quotations and citations omitted); *see also Neitzke v. Williams*, 490 U.S. 319, 326 (1989) (“Rule 12(b)(6) authorizes a court to dismiss a claim on the basis of a dispositive issue of law”).

Even under the liberal pleading standard of Federal Rule of Civil Procedure 8(a)(2), under which a party is only required to make “a short and plain statement of the claim showing that the pleader is entitled to relief,” a “pleading that offers ‘labels and conclusions’ or ‘a formulaic recitation of the elements of a cause of action will not do.’” *Iqbal*, 556 U.S. at 678 (quoting *Twombly*, 550 U.S. at 555). “[C]onclusory allegations of law and unwarranted inferences are insufficient to defeat a motion to dismiss.” *Adams v. Johnson*, 355 F.3d 1179, 1183 (9th Cir. 2004); *see also Starr v. Baca*, 652 F.3d 1202, 1216 (9th Cir. 2011) (“[A]llegations in a complaint or counterclaim may not simply recite the elements of a cause of action, but must contain sufficient allegations of underlying facts to give fair notice and to enable the opposing party to defend itself effectively”). The court must be able to “draw the reasonable inference that the defendant is liable for the misconduct alleged.” *Iqbal*, 556 U.S. at 663. “Determining whether a complaint states a plausible claim for relief . . . [is] a context-specific task that requires the reviewing court to draw on its judicial experience and common sense.” *Id.* at 663-64.

If a Rule 12(b)(6) motion is granted, the “court should grant leave to amend even if no request to amend the pleading was made, unless it determines that the pleading could not possibly be cured by the allegation of other facts.” *Lopez v. Smith*, 203 F.3d 1122, 1127 (9th Cir. 2000) (en banc) (internal quotation marks and citations omitted).

B. Motion to Strike

Pursuant to Federal Rule of Civil Procedure 12(f) a court may “strike from a pleading an

insufficient defense or any redundant, immaterial, impertinent, or scandalous matter.” “[T]he function of a 12(f) motion to strike is to avoid the expenditure of time and money that must arise from litigating spurious issues by dispensing with those issues prior to trial[.]” *SidneyVinstein v. A.H. Robins Co.*, 697 F.2d 880, 885 (9th Cir. 1983). “Rule 12(f) motions are generally ‘disfavored’ because they are ‘often used as delaying tactics, and because of the limited importance of pleadings in federal practice.’” *Bureerong v. Uvawas*, 922 F. Supp. 1450, 1478 (C.D. Cal. 1996) (citations omitted). Accordingly, Rule 12(f) motions “should not be granted unless the matter to be stricken clearly could have no possible bearing on the subject of the litigation[.] If there is any doubt whether the portion to be stricken might bear on an issue in the litigation, the court should deny the motion.” *Platte Anchor Bolt, Inc. v. IHI, Inc.*, 352 F. Supp. 2d 1048, 1057 (N.D. Cal. 2004) (internal citations omitted). “With a motion to strike, just as with a motion to dismiss, the court should view the pleading in the light most favorable to the nonmoving party.” *Id.* “Ultimately, whether the grant a motion to strike lies within the sound discretion of the district court.” *Cruz v. Bank of N.Y. Mellon*, No. 12-08846, 2012 WL 2838957, at *2 (N.D. Cal. July 10, 2012) (citing *Whittlestone, Inc. v. Handi-Craft Co.*, 618 F.3d 970, 973 (9th Cir. 2010)).

DISCUSSION

Both of Sabrdaran’s motions are premised on the same legal arguments: first, that the transactions at issue involve placing spread bets, which are not “securities” for the purposes of a Section 10(b)/Rule 10b-5 violation; second, that the alleged transactions did not occur in the United States and are therefore beyond the reach of U.S. securities laws; and third, that the complaint fails to allege that the “downstream” tippees—*i.e.*, the pharmacist and hairstylist—knew either that the information they received was confidential and obtained in breach of a duty or that the tips were made in exchange for a personal benefit. (Dkt. No. 21 at 2, 7; Dkt. No. 22 at 2, 8.)

A. Motion to Dismiss

1. Applicable Law

To place Sabrdaran’s arguments for dismissal in context, a brief sketch of the statutory scheme at issue is helpful. Rule 10b-5, enacted pursuant to Section 10(b) of the Exchange Act, 15

U.S.C. § 78j(b), sets forth alternative bases for securities fraud liability. In addition to prohibiting (1) the “mak[ing of] any untrue statement[s],” 17 C.F.R. § 240.10b-5, Rule 10b-5 also prohibits (2) the use, “in connection with the purchase or sale of any security,” of “any device, scheme, or artifice to defraud” or any other “act, practice, or course of business” that “operates . . . as a fraud or deceit.” Both Section 10(b) and Rule 10b-5 bar fraudulent conduct committed “in connection with the purchase or sale of any security.” 15 U.S.C. § 78j(b); 17 C.F.R. § 240.1b-5.

There are two types of insider trading that these laws prohibit. The first is the “‘traditional’ or ‘classical theory’ of insider trading liability, [Section] 10(b) and Rule 10b-5 are violated when a corporate insider trades in the securities of his corporation on the basis of material, non-public information.” *United States v. O’Hagan*, 521 U.S. 642, 641-52 (1997). Trading on such information qualifies as a “deceptive device” under [Section] 10(b) because “a relationship of trust and confidence [exists] between the shareholders of a corporation and those insiders who have obtained confidential information by reason of their position with that corporation.” *Chiarella v. United States*, 445 U.S. 222, 228 (1980). Thus, Section 10(b) acts to “prohibi[t] an insider, who has a fiduciary duty to a corporate entity, from using material non-public information to the insider’s advantage in order to make secret profits.” *SEC. v. Franco*, 253 F. Supp. 2d 720, 726 (S.D.N.Y. 2003). In contrast, under the “misappropriation theory” of insider trading, an individual violates Section 10(b) and Rule 10b-5 when when he misappropriates confidential information for securities trading purposes, in breach of a duty owed to the source of the information. Under this theory, a fiduciary’s undisclosed, self-serving use of a principal’s information to purchase or sell securities, in breach of a duty of loyalty and confidentiality, defrauds the principal of the exclusive use of that information. In lieu of premising liability on a fiduciary relationship between company insider and purchaser or seller of the company’s stock, the misappropriation theory premises liability on a fiduciary-turned-trader’s deception of those who entrusted him with access to confidential information. The misappropriation theory is . . . designed to protec[t] the integrity of the securities markets against abuses by outsiders to a corporation who have access to confidential information that will affect th[e] corporation’s security price when revealed, but who owe no fiduciary or other duty to that corporation’s shareholders.

O’Hagan, 521 U.S. at 652. To establish that a defendant is liable for insider trading under this misappropriation theory, the SEC must prove (1) that the information at issue was both material and nonpublic; (2) that the defendant breached a duty of confidentiality in sharing the information; and (3) that the defendant acted with scienter. *Aaron v. SEC*, 446 U.S. 680, 691 (1980). Courts have expanded insider trading liability to reach situations where the insider or misappropriator in possession of material nonpublic information (the tipper) does not himself trade but discloses the information to an outsider (a tippee) who then trades on the basis of the information before it is

publicly disclosed. *See Dirks v. SEC*, 463 U.S. 646 (1983).

2. The Complaint States a Claim Upon Which Relief May Be Granted

The SEC charges Sabrdaran and Afsarpour under the misappropriation theory of insider trading. Sabrdaran contends that the complaint must be dismissed in its entirety for three reasons: (1) because the spread bets Afsarpour was alleged to have made in the complaint do not qualify as a “security” for the purposes of Section 10(b) and Rule 10b-5; (2) that U.S. securities laws cannot reach the extraterritorial activities alleged in the Complaint; and (3) that the Complaint does not allege that the downstream tippees knew that the information was disclosed in violation of a relationship or trust or fiduciary duty or that the information was disclosed for the discloser’s personal benefit. The Court will address each argument in turn.

a. *Whether Afsarpour’s Spread Bets were made “In Connection With” Securities for the Purposes of Section 10(b) of the Exchange Act*

Sabrdaran’s first argument for dismissal is that the spread bets at issue in the complaint do not qualify as “securities” for the purposes of Section 10(b) / Rule 10b-5 liability. The SEC responds that, while spread bets themselves may not qualify as securities, they were certainly made “in connection with securities,” and this is all that Section 10(b) and Rule 10b-5 require to create liability. (Dkt. No. 29 at 9-10.) The Court concludes that the complaint falls just short of sufficiently alleging that the stock option purchases and spread bets at issue are “in connection with securities”: the spread bets are “in connection with” securities to the extent that they were hedged, but the complaint lacks sufficient allegations regarding the timing of the hedging.

As a threshold matter, Sabrdaran does not contend that Afsarpour’s common stock purchases are outside the reach of the Exchange Act. In any event, such an argument would fly in the face of established securities law, as fraudulent purchases of common stock certainly give rise to liability under Section 10(b) and Rule 10b-5. *See* 15 U.S.C. § 78c(a)(10) (defining “security” as including “stock”). Thus, the insider trading claims premised on Afsarpour’s purchases of InterMune common stock through his New York account certainly survive the instant motion to dismiss. Nevertheless, Sabrdaran contends that the complaint should be dismissed because Afsarpour’s spread bets are outside the scope of the Exchange Act.

Both Section 10(b) of the Exchange Act and the Securities Act define “security” by enumerating the types of instruments that qualify and, in the case of Section 10(b), those that do not. *See* 15 U.S.C. § 78c(a)(10); *id.* § 77b(a)(1).⁴ As the Supreme Court recently noted, “[f]or the purposes of these provisions, the [] Exchange Act defines ‘security’ *broadly* to include not just things traded on national exchanges, but also ‘any note, stock, treasury stock, security future, security-based swap, bond, debenture . . . [or] certificate of deposit for a security.’” *Chadbourne & Parke LLP v. Troice*, 134 S. Ct. 1058, 1063 (2014) (citation omitted). Spread bets are not included in the list of enumerated instruments under either statute. *See id.* Nor does the Exchange Act include spread bets in the list of instruments that are *not* securities. *See* 15 U.S.C. § 78c(a)(10). The Court assumes for purposes of this motion that the spread bets at issue here are not themselves a “security” within the meaning of the Exchange Act.

In *SEC v. Zandford*, 535 U.S. 813 (2002), however, the Supreme Court emphasized that the plain language of the Exchange Act only requires that a fraudulent scheme or device be “in connection with” a securities transaction. *Id.* at 819. The *Zandford* Court made clear that to meet this “in connection with” standard, “the securities transaction[] and breaches of fiduciary duty”

⁴ Specifically, the Exchange Act defines a security as:

[A]ny note, stock, treasury stock, security future, security-based stock swap, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or in general, any instrument commonly known as a “security”; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker’s acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

15 U.S.C. § 78c(a)(10). The Securities Act’s definition is almost identical, only it does not contain the final clause beginning with “but shall not include[.]” *Id.* § 77b(a)(1).

merely must “coincide.” *Id.* at 824-25. Interpreting *Zandford*, the Ninth Circuit has explained that the allegations of fraud merely must “‘coincide’ with the securities transaction” and be “easily characterized as having ‘more than some tangential relation to’ the securities themselves.” *Falkowski v. Imation Corp.*, 309 F.3d 1123, 1131 (9th Cir. 2002) (citation omitted), *amended by* 320 F.3d 905 (9th Cir. 2003), *abrogation on other grounds recognized by Proctor v. Vishay Intertech, Inc.*, 584 F.3d 1208 (9th Cir. 2009); *see also Ambassador Hotel Co. v. Wei-Chuan Inv.*, 189 F.3d 1017, 1026 (9th Cir. 1999) (“The court should consider whether the plaintiff has shown some causal connection between the fraud and the securities transaction in question.”). Along similar grounds, the Ninth Circuit has held that the “in connection with” test is “as broad and flexible as is necessary to accomplish the statute’s protective purposes[.]” and is met if the alleged fraud “somehow touches upon” or has “some nexus” with “any securities transaction[.]” *SEC v. Rana Res., Inc.*, 8 F.3d 1358, 1362 (9th Cir. 1993) (citations omitted).

The complaint here satisfies the “in connection with” test, assuming the SEC can allege that IG Index purchased the InterMune call options as a hedge to Afsarpour’s spread bet before InterMune’s December 17, 2010 announcement. First, there is no dispute that the InterMune call options purchased by IG Index are securities within the meaning of the Exchange Act. (Dkt. No. 1 ¶ 9.) Second, the complaint plausibly alleges that Afsarpour made the spread bet with IG Index based on confidential insider information. (*Id.* ¶¶ 26-36.) Third, the complaint’s factual allegations plausibly suggest that IG Index purchased the InterMune call options “in connection” with Afsarpour’s spread bet; indeed, the allegations suggest that *because of* Afsarpour’s spread bet IG Index purchased the InterMune call options. (*Id.* ¶¶ 37-38.) Thus, the alleged fraudulent activity—making the spread bet based on confidential insider information—is “connected with” the purchase of InterMune securities.

At least one other court has held that spread bets are made “in connection with” securities when they are hedged by the purchase of options which are indisputably securities within the meaning of the Act. In *SEC v. Suterwalla*, No. 06-cv-1446 DMS (LSP), 2008 WL 9371764 (S.D. Cal. Feb. 4, 2008), the SEC accused a British stockbroker of using material, non-public information about a company’s business negotiations to place spread bets with a U.K.-based

1 brokerage firm banking on an increase in the company's value. *Id.* at *1-2. The same day that the
 2 defendant placed his spread bets—and sometimes within two minutes—the U.K.-based brokerage
 3 firm purchased call options of the company on United States exchanges to hedge its risk from
 4 those bets. *Id.* at *3. Just as Sabrdaran argues here, the defendant in *Suterwalla* contended that
 5 his ten spread bets could not give rise to insider trading liability because they were not “securities”
 6 within the meaning of the Exchange Act. *Id.* at *2.

7 The court squarely rejected this argument, concluding that the SEC's allegations that the
 8 defendant knew that his “bets led to purchases of [the company's] options to hedge those bets”
 9 was “sufficient to satisfy the ‘in connection with’ requirement between [the defendant's] bet . . .
 10 and [his] broker's purchase of [securities] to hedge the bet.” *Id.* at *3. The court found the
 11 connection was sufficient to withstand a motion to dismiss given complaint allegations that the
 12 defendant placed the spread bets within three hours after obtaining the confidential information,
 13 and that the defendant himself was a stockbroker who knew that his broker would hedge his bets
 14 by purchasing the company's underlying securities. *Id.*⁵

15 While *Suterwalla* is not binding authority—and arguably applied an incorrect legal
 16 standard given that it predates the Supreme Court's decision in *Morrison v. National Australia*
 17 *Bank, Ltd.*, 561 U.S. 247 (2010), which clarified the scope and standards of the Exchange Act and
 18 is discussed in further detail below—the Court agrees with its reasoning that a foreign spread bet
 19 actually hedged by a broker purchasing call options on the underlying security on a United States
 20 exchange creates a sufficient connection with domestic securities. And the harm that this
 21 arrangement causes to individuals who trade on the United States market is clear: just as the
 22 insider information that caused the call option to be purchased predicted it would, the price of the
 23 underlying stock soars, yet the seller still must tender the stock to the broker at the lower price.
 24 Thus, when hedging is tied to spread bets, the spread bets cause harm in connection with domestic

25
 26 ⁵ The court held in the alternative that the complaint sufficiently alleged transactions “in
 27 connection with” securities based on a “common scheme” that included both the defendant's call
 28 option purchases—which were plainly securities within the meaning of Section 10(b)—and the
 spread bets. *Suterwalla*, 2008 WL 9371764, at *4 (“Even [if] one part of the course of business
 was legitimate, the entire scheme to defraud the market is within the SEC's jurisdiction.” (citing
Zandford, 535 U.S. at 821-22)).

1 securities. This is precisely the type of conduct that the Exchange Act is meant to deter.

2 But the complaint here is inadequate in one small respect: it is silent, or at least
3 ambiguous, as to the timing of IG Index's hedging. Specifically, the complaint does not allege
4 whether IG Index hedged Afsarpour's spread bets, that is, purchased the InterMune call options,
5 before or after InterMune's December 17, 2010 public announcement about Esbriet and thus after
6 the "confidential" information to which it was connected would have already been public. Of
7 course, if IG Index purchased the call options after the announcement, it would not have been a
8 very successful hedge; the complaint, however, does not allege that the hedge was successful, only
9 that it was made. At oral argument, the SEC represented that it could specifically allege that IG
10 Index's hedge was, in fact, placed *before* the public announcement. Thus, while the SEC does not
11 sufficiently allege that Afsarpour's spread bets were "in connection with" securities in the
12 complaint as written, if the SEC can include allegations that IG Index actually purchased the
13 InterMune call options prior to the company's public announcement about Esbriet, the SEC will
14 have stated a claim upon which relief may be granted. *See Suterwalla*, 2008 WL 9371764, at *3-
15 4.

16 Sabrdaran's arguments to the contrary are unpersuasive. First, his reliance on decades-old
17 Supreme Court case law obscures the line of authority that has developed in the intervening years
18 that emphasizes the broad scope of both Rule 10b-5 and the "in connection with" test.
19 Specifically, Sabrdaran cites *Tcherepnin v. Knight*, 389 U.S. 332, 336 (1967), for the proposition
20 that a spread bet is not a security, and that the test for determining whether something is a security
21 is "whether the scheme involves an investment of money in a common enterprise with profits to
22 come solely from the efforts of others." (Dkt. No. 21 at 13.) But the issue before the Court is not
23 whether Afsarpour's spread bets are analogous to investment contracts like in *Tcherepnin*. *Cf.* 389
24 U.S. at 336. Rather, based on the Supreme Court and Ninth Circuit case law that have followed
25 *Tcherepnin*, the question is whether the transaction at issue falls under the broadly-interpreted "in
26 connection with" requirement. As alleged, it does.

27 Sabrdaran's attempts to distinguish *Suterwalla* fare no better. To be sure, the Court agrees
28 that the facts alleged in *Suterwalla* gave rise to a stronger inference that the defendant in that case

1 knew that his spread bets would cause his broker to purchase the underlying securities in the
 2 United States market: in particular, that the defendant himself was a former investment broker
 3 with knowledge of the way the market works. 2008 WL 9371764, at *4. In contrast, the SEC
 4 here alleges only that Afsarpour's broker informed him that it *could* or *may* hedge his bets by
 5 purchasing the underlying securities. (Dkt. No. 1 ¶¶ 37-38.) Discovery in this case may well
 6 reveal that Afsarpour did not know that IG Index would hedge his spread bets; however, the facts
 7 alleged in the complaint give rise to a plausible inference that Afsarpour may have known, and
 8 this is sufficient to withstand a 12(b)(6) motion to dismiss.

9 Trying a different tack, Sabrdaran contends that the Court should not rely on *Suterwalla*
 10 because it "was decided before the U.S. Supreme Court threw out decades of precedent favoring
 11 the 'effects' test and adopted the 'transactional test' to determine whether the securities laws could
 12 reach extraterritorial transactions." (Dkt. No. 32 at 8 (citing *Morrison v. Nat'l Australia Bank,*
 13 *Ltd.*, 561 U.S. 247 (2010)).) The upshot of *Morrison* is that Section 10(b) and Rule 10b-5 only
 14 apply to transactions involving securities listed in domestic exchanges, not foreign exchanges.
 15 561 U.S. at 265, 267 ("[I]t is in our view only transactions in securities listed on domestic
 16 exchanges, and domestic transactions in other securities, to which § 10(b) applies."). However,
 17 the holding in *Suterwalla* squares with *Morrison*: the district court concluded the SEC's claims
 18 were actionable because the fraudulent spread bets were alleged to be made "in connection with"
 19 call options on the company's stock purchased on United States exchanges. *See Suterwalla*, 2014
 20 WL 9371764, at *4. In other words, in *Suterwalla*, as here, it is not the international spread bets
 21 themselves that are actionable under Section 10(b) and Rule 10b-5, but the fact that the spread bets
 22 are hedged by the broker's purchase of underlying securities on domestic exchanges.⁶ The instant
 23 case, with its hedging, does not present a *Morrison* scenario, and thus *Morrison* does not change
 24 the Court's conclusion.

25
 26 ⁶ *Suterwalla*'s conclusion that the spread bets give rise to insider trading liability because they are
 27 part of a common scheme with the securities purchases on domestic exchanges, may be the only
 28 part of the court's conclusion subject to change after *Morrison*. But this was only an alternative
 theory of affirming the sufficiency of the complaint and not, in any event, a theory the Court
 adopts here.

Finally, Sabrdaran contends that *Suterwalla* is inapposite because the court gave deference to the SEC's interpretation of the transaction at issue. (Dkt. No. 32 at 8.) The *Suterwalla* court, almost in passing, noted that its conclusion that the spread bets were "in connection with" securities based on the broker's purchase of the underlying security to hedge the bets was based in part on giving "weight to the SEC's reasonable interpretation of the transaction and [also on] the broad application of the securities statutes and rules to the allegations in the [complaint]." *Suterwalla*, 2008 WL 9371764, at *4. But the analysis in *Suterwalla* did not end there; in fact, rather than mere blind reliance on the agency's interpretation of the transaction, the court—as set forth above—provided a detailed explanation of why the spread bets, under the circumstances presented, were sufficiently "in connection with" securities to give rise to insider trading liability. In any event, even if this Court were not to consider *Suterwalla*, it would reach the same conclusion.

In short, for all of the above reasons, the complaint will not be dismissed in its entirety. With respect to the 75 shares of common stock that Afsarpour purchased, the complaint sufficiently alleges that Afsarpour engaged in transactions that were "in connection with" domestic securities for the purposes of Section 10(b) and Rule 10b-5. However, to the extent the SEC wishes to hold Defendants liable for insider trading based on Afsarpour's spread bets, the SEC must amend the complaint to include allegations regarding the timing of IG Index's hedges.

b. *Whether the Exchange Act Reaches the Transactions at Issue*

Sabrdaran next contends that even if the spread bets are "in connection with" securities, the instant complaint represents an improper attempt to apply the Exchange Act to overseas securities transactions in "direct contravention" of the Supreme Court's decision in *Morrison v. National Australia Bank, Ltd.*, 561 U.S. 247 (2010). (Dkt. No. 21 at 14.) The SEC insists that Congress overruled *Morrison* when it amended the jurisdictional language of the Exchange Act through Section 929P(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"), Pub. L. No. 111-203, 124 Stat. 1376 (2010), and, in any event, the allegations in the complaint pass muster under the test set forth in *Morrison*. (Dkt. No. 29 at 12-14.) The Court need only address the latter argument: the complaint states a claim—with respect to common

1 stock trades, as is, and with respect to the spread bets (assuming the SEC can allege that IG Index
2 hedged Afsarpour's hedge bets prior to InterMune's public announcement about Esbriet) even
3 under the stricter test laid out in *Morrison*; thus, it need not determine whether the Dodd-Frank
4 Act revived the broader tests that *Morrison* rejected.

5 In *Morrison*, the Supreme Court addressed the extraterritorial reach of Section 10(b) and
6 Rule 10b-5, and held that there is a presumption against extraterritorial application of the
7 Exchange Act. 561 U.S. at 266-67. In that case, foreign investors brought a civil action against a
8 foreign corporation for securities fraud relating to securities traded on foreign exchanges. *Id.* at
9 272. Australian investors purchased shares in an Australian bank whose stock shares were listed
10 on the Australian Stock Exchange Limited, but not in a United States—*i.e.*, domestic—
11 exchange. *See id.* Some executives at the bank had manipulated the financial models of a
12 subsidiary, causing the subsidiary's income stream to appear more valuable than it really
13 was. *See id.* The resulting write-downs caused the bank's share price to drop. *See id.* The Court
14 held that because the case did not involve securities listed on a domestic exchange, and because all
15 aspects of the purchases occurred abroad, section 10(b) could not apply and the complaint must be
16 dismissed. *See id.* at 273.

17 The *Morrison* court cautioned that “there is no affirmative indication in the Exchange Act
18 that [Section] 10(b) applies extraterritorially, and we therefore conclude that it does not.” *Id.* at
19 265. The Court explained that “[t]he focus of the Exchange Act is . . . upon purchases and sales of
20 securities in the United States[,]” and, accordingly, the statute “reaches the use of a manipulative
21 or deceptive device or contrivance only in connection with the purchase or sale of a security listed
22 on an American stock exchange, and the purchase or sale of any other security in the United
23 States.” *Id.* at 273. The Supreme Court rejected various circuit courts' formulations of the test to
24 determine whether conduct abroad falls within Section 10(b)'s reach, including the Second
25 Circuit's “effects” and “conduct” tests, which analyzed whether a particular transaction had a
26 substantial effect in the United States. *Id.* at 257. Instead, the Supreme Court adopted its own
27 “transactional test,” which asks “whether the purchase or sale [at issue] is made in the United
28 States, or involves a security listed on a domestic exchange[.]” *Id.* at 269-70.

Although the Ninth Circuit has not yet addressed *Morrison*, other Circuit courts have. In doing so, they have seized on the idea that the first transactional test depends simply on whether the transaction involves the purchase or sale of a security listed on an American exchange; for the second test, if the security is not so listed, “it is the location of the *transaction* that establishes (or reflects the presumption of) the [Exchange Act’s] inapplicability.” *United States v. Georgieu*, — F.3d —, Nos. 10-4774, 11-4587, 12-2077, 2015 WL 241438, at *5 (3d Cir. Jan. 20, 2015) (citations omitted); *see also Absolute Activist Master Fund LLC v. Ficeto*, 677 F.3d 60, 66 (2d Cir. 2012) (“[A] securities transaction is domestic when the parties incur irrevocable liability to carry out the transaction within the United States or when title is passed in the United States.”). As the Third Circuit recently explained, what matters is whether “some of the relevant transactions *required the involvement* of a purchaser or seller working with a market maker and committing to a transaction in the United States, incurring irrevocable liability in the United States, or passing title in the United States.” *Georgieu*, — F.3d —, 2015 WL 241438, at *6.

Given its recent vintage, not many district court cases have delved at all—let alone deeply—into the scope of the “transactions test” set forth in *Morrison*, but several from the Southern District of New York are instructive. In *SEC v. Compania Internacional Financiera S.A.*, No. 11 Civ. 4904 (DLC), 2011 WL 3251813 (S.D.N.Y. July 29, 2011), defendant Chartwell Asset Management Services (“Chartwell”) was charged with insider trading based on its purchase in the U.K. on a U.K. exchange of several contracts for difference (“CFDs”). *Id.* at *1. The CFDs gave it the right to acquire the future price movement of the underlying company’s common stock, which was traded on U.S. exchanges, without taking ownership of the underlying shares. *Id.* at *1, 3. Chartwell’s broker, however, purchased shares of the underlying common stock before pricing the CFD. *Id.* at *6. The *Compania Internacional Financiera* court concluded that the CFDs at issue were securities because the “broker purchases matching shares of the stock” on the United States market just before the defendant purchased the CFDs. *Id.* The CFD purchase price reflected any influence of the underlying stock purchase, and the CFDs were therefore *tied* to the purchase of a domestic security. *Id.* In reaching this conclusion, the court emphasized that exempting such transactions—that is, foreign CFD purchases—from the reach of Section 10(b)

1 “misreads *Morrison*, which never states that a defendant must itself trade in securities listed on
2 domestic exchanges or engage in other domestic transactions.” *Id.* at *6. In addition, the court
3 concluded that the CFDs at issue were the “functional equivalent” of the underlying stock because
4 “CFD holders receive the benefit of dividends paid by the company on shares and CFD contracts
5 may include voting rights on the shares” and the CFD prices follow identically the prices of the
6 underlying stock. *Id.*

7 *In re Optimal U.S. Litigation*, 865 F. Supp. 2d 451, 454-55 (S.D.N.Y. 2012), reached the
8 opposite result. Notably, the *Optimal* court did not expressly disagree with *Compania*
9 *Internacional Financiera*’s interpretation of “in connection with” in the context of examining
10 Section 10(b)’s extraterritorial reach after *Morrison*; rather, the case involved a different type of
11 transaction. In *Optimal*, the court dismissed a Section 10(b) complaint against defendants that
12 solicited foreign investments in a U.S. company pursuant to certain “explanatory memoranda” that
13 set forth a complex investment strategy involving, among many other things, the purchase of
14 stocks and call options on domestic exchanges. *Id.* at 455. The Court declined to find a sufficient
15 connection between foreign investments in Optimal U.S. and domestic securities for a number of
16 reasons, including that the investment strategy was very complex, there was no “direct
17 correlation” between the foreign investments and the purchase of domestic stock, and there were
18 no allegations that any such trades on domestic exchanges were actually made. *Id.* Thus, the
19 relationship between the defendant’s foreign investments and any domestic security was too
20 attenuated to give rise to Section 10(b) liability for extraterritorial transactions. *Id.*

21 The facts alleged in this case look more like *Compania Internacional Financiera* than
22 *Optimal*. The complaint alleges that Afsarpour’s broker told him that it may hedge his spread bets
23 by purchasing shares of the underlying InterMune stock and it actually did so before posting the
24 spread bets to his account (*see* Dkt. No. 1 ¶¶ 37-38), though this timing will become even clearer
25 once the SEC amends the complaint, as it represented. The complaint also alleges that spread bets
26 function much like CFDs: the placer of the spread bet, like the purchaser of the CFD, pays money
27 betting on the increased price of the underlying security. Unlike *Optimal*, where there were no
28 allegations that the domestic security was ever actually purchased, the complaint here alleges that

the broker actually purchased the underlying stock in connection with the defendant's foreign transaction just as in *Compania Internacional Financiera*. And while Sabrdaran focuses on the fact that the spread bets here are not the "equivalent" of the underlying stock and did not necessarily come with the same level of connection as the CFDs in *Compania Internacional Financiera*, other courts have taken this approach even post-*Morrison* where the foreign transaction involved a broker purchasing the underlying United States security. *See SEC v. Maillard*, No. 13-cv-4299 (VEC), 2014 WL 1660024, at *4 (S.D.N.Y. Apr. 23, 2014) (denying motion to dismiss Section 10(b) insider trading claims against defendant who purchased CFDs abroad because the transactions "required [a broker] to purchase the underlying security traded" on a domestic exchange and, though "one could theoretically imagine a case in which a CFD was purchased and the seller decided not to hedge the transaction by purchasing the underlying security, that did not happen here"). At bottom, just as in *Compania Internacional Financiera* and *Maillard*, that Afsarpour himself did not purchase the underlying domestic securities is not fatal to the complaint. Rather, as set forth above—and to the extent that the SEC amends the complaint to include allegations about the timing of the hedges—the SEC has sufficiently alleged that Afsarpour's spread bets "involved" a security traded on domestic exchanges because IG Index actually bought call options in the underlying security before posting any of his spread bets to his account. *See Morrison*, 561 U.S. at 269-70.

In light of the Court's decision that the allegations in the complaint sufficiently meet the transactional test, it need not resolve the debate over whether the Dodd-Frank Act overruled *Morrison*, as the SEC contends. *See SEC v. Chicago Convention Ctr., LLC*, 961 F. Supp. 2d 905, 916-17 (N.D. Ill. 2010); *see also Compania Internacional Financiera*, 2011 WL 3251813, at *6 n.2 (suggesting that the Section 929P(b) of the Dodd-Frank Act may have reinstated the tests rejected in *Morrison* but declining to determine that issue given that the foreign CFDs at issue were sufficiently connected to domestic securities).⁷

⁷ As the parties have noted, a number of other cases from the Southern District of New York have made passing references stating or suggesting that Section 929P(b) of the Dodd-Frank Act may have revived extraterritorial reaches of Section 10(b) claims after *Morrison*, but none actually analyzed the issue. *See, e.g., Liu v. Siemens*, 978 F. Supp. 2d 325, 328 (S.D.N.Y. 2013); *SEC v.*

c. *Whether the Tippees Knew that the Information was Confidential*

Finally, Sabrdaran contends that the complaint must be dismissed because, even if the spread bets are actionable and Section 10(b) can reach them, there are insufficient allegations to state a claim for insider trading on a misappropriation theory. Specifically, Sabrdaran argues that there are no allegations that the tippees—*i.e.*, the recipients of material, non-public information—including Afsarpour and the “downstream tippees” that he tipped (the pharmacist and the hairdresser)—knew that the inside information was disclosed in violation of a relationship of trust or in exchange for a personal benefit. Thus, at least from Sabrdaran’s perspective, the entire complaint should be dismissed for failure to state a claim. At bottom, Sabrdaran asks the Court to rule that he may only be liable for, that is, have to pay as disgorgement, his own profits (if any) from the purported insider trading scheme, and not those of Afsarpour or his tippees.

To state a claim for a Section 10(b) insider trading violation based on misappropriation (tipping) liability, the plaintiff must allege facts sufficient to establish the plausibility of the following elements: (1) the tipper possessed material, nonpublic information regarding the issuer of a security; (2) the tipper disclosed the information to the tippee; (3) the tippee traded in the issuer’s securities while in possession of the information; (4) the tippee knew or should have known that the information was disclosed in violation of a relationship of trust; and (5) the tipper benefited from the disclosure to the tippee. *Dirks v. SEC*, 463 U.S. 646, 654-66 (1983). Here—given the Court’s ruling that the spread bets are actionable—Sabrdaran argues that the fourth and fifth elements are lacking.

i. *Afsarpour as Tippee*

The SEC’s complaint sufficiently alleges all five elements of insider trading liability as to the trades that Afsarpour engaged in himself; indeed, Sabrdaran concedes that the first *four* elements are present. (Dkt. No. 21 at 20 (“[T]he SEC alleges that Mr. Afsarpour knew Dr.

Tourre, No. 1 Civ. 3229 (KBF), 2013 WL 2407172, at *1 n.4 (S.D.N.Y. June 4, 2013); *SEC v. Gruss*, No. 11 Civ. 2420, 2012 WL 3306166, at *3 (S.D.N.Y. Aug. 13, 2012); *Cornwell v. Credit Suisse Grp.*, 729 F. Supp. 2d 620, 627 n.3 (S.D.N.Y. 2010). Thus, the Court declines to rely on these conclusions. *See, e.g., Turner v. Imperial Stores*, 161 F.R.D. 89, 97 (S.D. Cal. 1995) (declining to rely on the conclusions of other courts reached without analysis or citation).

1 Sabrdaran had a duty to maintain the confidentiality of InterMune’s information[.]”.) Thus, the
 2 only element at issue with respect to Afsarpour is whether the complaint sufficiently alleges that
 3 Sabrdaran benefited from the disclosure to Afsarpour. It does. The “personal benefit” required
 4 for insider trading liability may be pecuniary, or financial, in nature. *United States v. Jiau*, 734
 5 F.3d 147, 152-53 (2d Cir. 2013). But the benefit need not be financial, so long as it “of some
 6 consequence[.]” such as a “meaningfully close personal relationship that generates an exchange
 7 that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly
 8 valuable nature.” *United States v. Newman*, 773 F.3d 438, 452 (2d Cir. 2014),

9 Here, the SEC alleges that, following the tips and within six months after Afsarpour reaped
 10 a substantial profit from his trades, he gave \$26,000 to Sabrdaran. This allegation supports a
 11 plausible inference that Sabrdaran benefited from Afsarpour’s trading. At the very least, then, the
 12 bulk of the allegations in the complaint—at least the \$877,369 in profits that Afsarpour obtained
 13 as tippee—survive Sabrdaran’s motion to dismiss.

14 ii. Pharmacist and Hairdresser as Downstream, Secondary Tippees

15 The downstream tippees present a more complicated case. The question is whether the
 16 SEC may proceed with its claims of liability against Sabrdaran relating to the \$107,900 and
 17 \$91,800 that the pharmacist and hairdresser respectively profited. The SEC concedes that the
 18 complaint nowhere alleges that the pharmacist or hairdresser were aware of Sabrdaran’s duty not
 19 to disclose confidential information, his breach of that duty, or any benefit he received or
 20 Afsarpour received by tipping them. (Dkt. No. 29 at 17-18.)

21 In light of the SEC’s concession, Sabrdaran argues that the Second Circuit’s recent
 22 decision in *United States v. Newman*, 773 F.3d 438 (2014), bars any liability for Sabrdaran
 23 stemming from the pharmacist or hairdresser’s transactions. In *Newman*, the Second Circuit held
 24 that “in order to sustain a conviction for insider trading, the Government must prove beyond a
 25 reasonable doubt that the tippee knew that an insider disclosed confidential information *and* that
 26 he did so in exchange for a personal benefit.” 773 F.3d at 442. This rule squares with the
 27 Supreme Court’s earlier decision in *Dirks v. SEC*, 463 U.S. 646, 654-66 (1983); *Newman* made
 28 explicit that the tippee must also have knowledge of the tipper’s benefit. The *Newman* court

expressed concern at the recently expanded scope of SEC insider trading prosecutions, “which are increasingly targeted at remote tippees many levels removed from corporate insiders” instead of those “who directly participated in the tipper’s breach . . . or tippees who were explicitly apprised of the tipper’s gain by an intermediary tippee.” *Id.* at 448 (citations omitted). Sabrdaran alleges this is what the SEC is doing here in seeking to hold him liable for the profits obtained by the pharmacist and hairdresser who, under the standard set forth in *Newman*, do not qualify as tippees. The SEC, however, does not seek a finding of liability against Sabrdaran based on the tips to the pharmacist and hairdresser; rather, the SEC argues that the allegations related to these downstream tippees are relevant only to the remedies stage of this litigation—that is, the scope of disgorgement attributable Sabrdaran and Afsarpour for their insider trading. (*Id.*)

“It is well settled in the Ninth Circuit that a tipper can be required to disgorge his tippees’ profits, whether or not the tippees themselves have been found liable.” *SEC v. Gowrish*, No. C 09-05883 SI, 2011 WL 2790482, at *7 (N.D. Cal. July 14, 2011); *see also SEC v. Clark*, 915 F.2d 439, 453 (9th Cir. 1980) (“a tipper may be liable for the profits realized by this tippees”). While the usual focus of a disgorgement figure is the amount of a given defendant’s unjust enrichment, disgorgement may extend beyond a liable tipper or tippee’s own profits because it is designed both “to deprive a wrongdoer of unjust enrichment, *and* to deter others from violating securities laws by making violations unprofitable.” *SEC v. Platforms Wireless*, 617 F.3d 1072, 1096 (9th Cir. 2010) (emphasis added) (citation omitted); *see also, e.g., Gowrish*, 2011 WL 2790482, at *8. The consensus among district courts is that the court “has the discretion to order that [a] defendant disgorge all of the profits of the insider trading scheme”—even those beyond the transactions that gave rise to securities fraud liability—“but the [c]ourt is not required to do so.” *Gowrish*, 2011 WL 2790482, at *7; *see also SEC v. Falbo*, 14 F. Supp. 2d 508, 528 & n.25 (S.D.N.Y. 1998) (holding tipper liable for profits he realized trading but declining “to hold him jointly and severally liable for anyone else’s illicit gains” where “the SEC fail[ed] to present any evidence indicating that [he] derived any financial benefit from the illegal trading of anyone he tipped”).

There is nothing in *Newman* that suggests that the Second Circuit intended to undercut the long line of authority holding that an individual liable for insider trading may be on the hook for

1 profits gained by tippees, even where the tippees are not themselves liable for insider trading
2 because they did not have the requisite knowledge. *See, e.g., Clark*, 915 F.2d at 454; *SEC v.*
3 *Contorinis*, 743 F.3d 296, (2d Cir. 2014) (“Our prior cases indicate that an insider trader may be
4 ordered to disgorge not only the unlawful gains that accrue to the wrongdoer directly, but also the
5 benefit that accrues to third parties whose gains can be attributed to the wrongdoer’s conduct. We
6 have long applied that principle in the tipper-tippee context.”). Thus, Sabrdaran may have to
7 disgorge Afsarpour’s profits even if Afsarpour is ultimately found not liable, and Afsarpour may
8 have to disgorge the profits of the hairdresser and pharmacist even though they will not be found
9 liable in this lawsuit. The more challenging question is whether the Court can order Sabrdaran to
10 disgorge the profits of the hairdresser and pharmacist, that is, his indirect tippees. Again,
11 however, *Newman*, the case upon which Defendant’s motion is premised, does not say “no” as a
12 matter of law. Accordingly, at this stage in the litigation the Court declines to dismiss the
13 complaint, or part of it, based on these tippees’ lack of knowledge about the impropriety of the
14 information they received or the expectation of a benefit to the tipper.

15 **B. Motion to Strike**

16 Sabrdaran’s motion to strike advances the same legal arguments as his motion to dismiss.
17 Indeed, most of the content of the motions are identical. Because the Court has already addressed
18 each of these arguments, no separate analysis is required. For the reasons described above, none
19 of Sabrdaran’s legal arguments warrant striking allegations from the complaint. Even absent
20 amendment from the SEC to add allegations about the timing of the hedging, the allegations in the
21 complaint as written pertaining to Afsarpour’s spread bets placed with a London-based broker that
22 hedged his bets by purchasing securities on domestic exchanges are certainly relevant evidence
23 that could bear on this litigation. *Cf. Platte Anchor Bolt*, 352 F. Supp. 2d at 1057. The profits that
24 the downstream tippees earned may be attributable to Defendants, so—while not themselves
25 charged with insider trading—their actions likewise bear on the subject of the litigation. *See id.* It
26 may well be that the SEC cannot succeed on Section 10(b) claims premised on certain challenged
27 transactions and may not be entitled to disgorgement of profits from the downstream tippees, but
28 the SEC has alleged sufficient facts to proceed to discovery on all of these allegations as all are

certainly relevant to the actionable claims at bar. The Court therefore declines to strike these allegations from the complaint.

CONCLUSION

For the reasons described above, the Court DENIES Sabrdaran's motion to strike portions of the complaint and GRANTS IN PART Sabrdaran's motion to dismiss on the narrow issue of the absence of allegations about the timing of IG Index's hedging. This dismissal is without prejudice, and the Court grants the SEC leave amend its pleading to include such allegations. Any amended complaint shall be filed by March 18, 2015.

This Order disposes of Docket Nos. 21 and 22.

IT IS SO ORDERED.

Dated: March 2, 2015


 JACQUELINE SCOTT CORLEY
 United States Magistrate Judge

United States District Court
 Northern District of California